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1st Session }

SENATE

{REPORT
{No. 781

THE REVENUE ACT OF 1951

REPORT
OF THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
TO ACCOMPANY
H. R. 4473
A BILL TO PROVIDE REVENUE,
AND FOR OTHER PURPOSES



SEPTEMBER 18 (legislative day, SEPTEMBER 13), 1951.—Ordered
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Calendar No. 737

82D CONGRESS
1st Session

SENATE

REPORT
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REVENUE ACT OF 1951

SEPTEMBER 18 (legislative day, SEPTEMBER 13), 1951.—Ordered to be printed

Mr. GEORGE, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 4473]

I. GENERAL STATEMENT

This is the third time your committee has been called upon to consider revenue increases since the outbreak of hostilities in Korea a little over a year ago. The Revenue Act of 1950, which became law on September 23, 1950, increased revenues by \$6.1 billion; the Excess Profits Tax Act of 1950, which became law on January 3, 1951, raised revenues by \$3.9 billion; and it is estimated your committee's bill will increase revenues by \$5.5 billion. In the fiscal year 1952 the bill is expected to increase revenues by \$2.7 billions, raising collections this year to \$64.7 billion.

The revenue raised by these two acts, plus that provided by your committee's bill, will add to Federal revenue \$15½ billion at calendar year 1951 levels of income and in a full year of operation. These three revenue-raising measures on the average will increase the taxes of individuals by 29.0 percent of the amount which would have been due under the prior law, and will raise corporate taxes by 52.9 percent.

Never before has so much additional revenue been raised in so short a period of time. Moreover, these three revenue measures have brought the income tax burdens of most corporate and individual taxpayers near the World War II peak and for many such taxpayers the rates imposed under your committee's bill are above the maximum rates imposed during World War II. As a result your committee has serious doubts as to the feasibility of raising any substantial additional amounts of revenue from income tax sources. This is said although it is recognized that present expenditure estimates made by the executive departments indicate very substantial additions to Federal expenditures next year. In view of this, your committee believes that every effort must be made to reduce expenditures.

Your committee's bill provides tax increases in all of the major tax areas. Individual income taxes for most taxpayers are raised

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by 11 percent effective November 1, 1951. The top income tax rate of corporations is raised to 52 percent. The ceiling rate on excess profits taxes is raised to provide a maximum effective income and excess profits tax rate of about 69 percent. Excise taxes also are raised, primarily those on alcoholic beverages, tobacco, gasoline, automobiles, and electric, gas, and oil appliances, and a new tax is imposed on wagering. The bill also provides taxes for certain types of presently exempt income of cooperatives, mutual savings banks, and building and loan associations.

II. REVENUE ESTIMATES

Table I shows the estimated increase in tax liabilities under your committee's bill and under the House bill in a full year of operation, and also the effect of these bills on collections in the fiscal year 1952. Both the increases in liabilities in a full year and the increases in collections in the fiscal year 1952 are shown by major revenue sources.

It is estimated that your committee's bill will increase tax liabilities in a full year of operation by approximately \$5,500 million, and that it will increase collections in the fiscal year 1952 by about \$2,700 million. The increases in collections in the fiscal year 1952 are considerably smaller than the increase in tax liabilities provided by your committee's bill in a full year of operation, both because the changes are not fully effective in the fiscal year 1952, and because collections tend to lag behind the incurring of liabilities. The House bill would increase tax liabilities in a full year of operation by approximately \$7,200 million and would increase collections in the fiscal year 1952 by about \$4,900 million.¹ The major differences from the standpoint of revenue between the House bill and your committee's bill can be accounted for by the fact that your committee did not impose as large increases in individual and corporate taxes as the House, and did not subject corporate dividends to withholding.

The increase in excise tax collections in the fiscal year 1952 assumes that the changes in these taxes become effective as of November 1, 1951, the same date as is provided in your committee's bill for the increases in the individual income tax.

TABLE 1.—Estimated effect of the House bill and committee bill on tax liabilities in a full year of operation and on collections in the fiscal year 1952

[In millions]

	House bill		Committee bill	
	Full year effect	Fiscal year 1952 effect	Full year effect	Fiscal year 1952 effect
Individual income tax.....	\$2,847	¹ \$1,652	\$2,367	\$1,379
General corporate tax changes.....	² 2,855	² 1,740	² 2,060	(²)
Tax-exempt organizations.....	0	0	150	0
Structural changes in the income taxes.....	245	705	-224	-219
Structural changes in the excess profits tax.....	0	0	-120	-120
Structural changes in the estate and gift taxes.....	(*) 0	(*)	-2	0
Excise tax changes.....	1,252	³ 811	1,275	⁴ 823
Total.....	7,199	4,908	5,506	2,733

*Negligible.

¹ Estimate based on the assumption House provision is effective Nov. 1, 1951, instead of Sept. 1 as provided by the House bill.

² Net increase after allowing for reduction in individual income taxes due to lower dividends.

³ This larger amount is due primarily to the acceleration of collections on withholding.

⁴ Assumes excise tax changes effective Nov. 1, 1951.

¹ This assumes excise and individual income tax increases provided by the House bill are effective November 1, 1951.

III. CHANGES IN THE INDIVIDUAL INCOME TAX

Your committee's bill, in a new rate schedule, provides the lower of the following two increases: An 11-percent increase in present tax rates, or an 8-percent additional tax based on the surtax net income² remaining after the deduction of present taxes. The House bill provided an additional tax equal to 12½ percent of the existing tax for all income brackets except the very highest.

The increase provided by your committee applies only to the tax on ordinary income. The increase under the House bill also applies to the alternative tax on capital gains.

The rate increases under your committee's bill, in effect, are made as of November 1, 1951, the date when increased withholding becomes effective, and are to terminate as of December 31, 1953. Under the House bill the rate increases, in effect, are made as of September 1, 1951, the date when increased withholding was to become effective under that bill, but no termination date was set.

Both your committee's bill and the House bill grant to heads of households some of the benefits of income splitting now enjoyed by married persons. Under your committee's bill they obtain one-quarter of the benefits of income splitting, and under the House bill, one-half. For calendar year taxpayers this head-of-household provision under both bills is to be effective beginning in 1952.

It is estimated that in a full year of operation the individual income tax rate changes provided by your committee's bill will increase liabilities by \$2,394 million and that on the same basis the head-of-household provision provided by your committee's bill will decrease revenues by \$27 million. Thus, it is estimated that the combined effect of these provisions will be to increase liabilities in a full year of operation by \$2,367 million.

Since, in effect, the rate changes made by your committee's bill do not become operative until November 1, and the head-of-household provision for practically all taxpayers will not be effective until January 1, 1952, collections in the fiscal year 1952, ending June 30, 1952, will not fully reflect the increases provided. Therefore, fiscal year 1952 collections under your committee's bill are expected to be increased by only about 58 percent of the \$2,367 million, or by \$1,379 million. Since the rate changes made by the House bill were to be effective as of September 1, 1951, the report by the Committee on Ways and Means of the House estimated collections in fiscal year 1952 would be increased by \$1,947 million. However, had the effective date been November 1, as under your committee's bill, fiscal year 1952 collections under the House bill would have been increased by \$1,652 million.

A. RATE CHANGES

1. Description

For taxable years beginning after October 31, 1951, your committee's bill increases the present individual income taxes by the lower of either about 11 percent of the present combined normal tax and surtax, or approximately 8 percent of the surtax net income³ after present taxes. These increases are to terminate as of December 31, 1953. The House bill increases the present normal tax and surtax

² Surtax net income is income after deductions and exemptions.

³ Surtax net income is income after deductions and exemptions.

in most cases by 12½ percent for taxable years beginning after August 31, 1951. No termination date for this increase is provided. The 11- or 8-percent increase provided by your committee's bill is incorporated in the surtax rate schedule. Under the House bill the 12½-percent increase is to be a separate tax computation, although it is incorporated in the tax table used by those with adjusted gross incomes of \$5,000 or less.

The new surtax table in your committee's bill provides surtax bracket rates ranging from 19.2 percent on the first \$2,000 of surtax net income to 88.7 percent on surtax net income in excess of \$200,000. This, when combined with the flat 3-percent normal tax, gives total rates which range from 22.2 percent on the first \$2,000 of taxable income to 91.7 percent on taxable income in excess of \$200,000. The combined normal tax and surtax rates (including the 12½ percent increase) under the House bill range from 22.5 percent on the first \$2,000 of surtax net income to 94.5 percent on surtax net incomes in excess of \$80,000. Under present law these combined rates range from 20 percent on the first \$2,000 of taxable income to 91 percent on incomes in excess of \$200,000.

Your committee's bill raises the effective rate limitation, or maximum combined normal tax and surtax on total net income, from the 87 percent provided by present law to 88 percent. This effective rate limitation prevents an individual's total net income from being taxed at a rate higher than 88 percent, although the bracket rate on income in excess of \$200,000 permits a portion of an individual's income to be taxed at as high a rate as 91.7 percent. Under the House bill the effective rate limitation is raised to 90 percent.

Your committee's bill also provides a new surtax rate schedule for the calendar year 1951, adding to the present tax burden about one-sixth of the increase provided for 1952 and 1953. Thus, for 1951 the present tax is increased by the lower of either nearly 2 percent of the existing law tax, or by slightly over 1 percent of surtax net income after deducting the present tax. This is roughly the equivalent of making the full 11-percent or 8-percent increase effective November 1, 1951. The House bill which would have been effective as of September 1, 1951, provided a 4-percent increase in the present law tax for calendar year 1951 taxpayers. This would have been roughly the equivalent of making the tax increase effective for the last third of the year. The combined normal tax and surtax bracket rates under your committee's bill for the calendar year 1951 range from 20.4 percent on the first \$2,000 of taxable income to 91.1 percent on taxable income over \$200,000. Under the House bill these rates range from 20.8 percent on the first \$2,000 of taxable income, to 92.56 percent on taxable incomes in excess of \$200,000. Under your committee's bill the effective rate limitation for calendar year 1951 taxpayers is 87.2 percent, and under the House bill, 88 percent.

Your committee's bill also adds a provision which makes inapplicable, for 1951, the penalties and additions to tax for willful failure to make declarations or pay estimated tax with respect to the additional tax imposed on individuals by this bill.

For 1952 and subsequent years and for the last third of 1951 the House bill provides an increase in the alternative tax on capital gains of individuals. For 1952 and subsequent years this increase

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is 12½ percent, the same increase as provided for the normal tax and surtax. Applying this to the present 25-percent capital gains tax gives a new rate of 28.125 percent. For the calendar year 1951 the House bill provides a 4-percent increase in the alternative tax on capital gains resulting in a total capital gains tax rate of 26 percent. Under your committee's bill no change is made in the alternative tax on capital gains. Thus, the rate remains at 25 percent both for 1951 and 1952 and subsequent years.

Under both your committee's bill and the House bill new withholding tables are provided to reflect the increased taxes. The withholding in both of these tables is at approximately 20 percent as contrasted to 18 percent in the table in present law. Similar adjustments are made in the percentage method of withholding. A withholding tax rate of approximately 20 percent collects the full amount ordinarily due on the beginning rates provided by your committee's bill and the House bill after allowance for the standard deduction.

Table 2 shows the amount of tax paid at selected net income levels under present law, under the House bill for the calendar year 1952 and subsequent years, and under your committee's bill for the calendar years 1952 and 1953. The tax burden is shown separately for single persons with no dependents, for married couples with no dependents, and for married couples with two dependents. The tax of single persons, of married couples with no dependents and of married couples with two dependents shown in this table differ because the amount of tax paid is shown by net income⁴ classes. Net income for these classes of taxpayers differs from the income on which the tax is based because a single person receives one \$600 exemption, a married couple two \$600 exemptions and a married couple with two dependents four \$600 exemptions. In addition, married couples receive the benefits of income-splitting.

⁴ Net income is income after deductions but before exemptions.

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TABLE 2.—Comparison of individual income-tax burdens under present law with those under the House bill and Finance Committee bill for 1952 and 1953

SINGLE PERSON, NO DEPENDENTS

Net income (after deductions but before exemptions)	Amount of tax		
	Present law	House bill	Finance Committee bill
\$800.....	\$40	\$45	\$44
\$1,000.....	80	90	89
\$2,000.....	280	315	311
\$3,000.....	488	549	542
\$4,000.....	708	797	786
\$5,000.....	944	1,062	1,048
\$6,000.....	1,780	2,003	1,974
\$7,000.....	2,436	2,741	2,704
\$8,000.....	4,448	5,004	4,940
\$9,000.....	6,942	7,810	7,718
\$10,000.....	9,796	11,021	10,872
\$15,000.....	26,388	29,687	28,234
\$20,000.....	66,798	74,831	69,344
\$25,000.....	247,274	263,831	251,522
\$30,000.....	429,274	450,000	434,922
\$1,000,000.....	1,870,000	2,900,000	2,880,000

MARRIED COUPLE, NO DEPENDENTS

\$1,500.....			
\$2,000.....	\$60	\$68	\$67
\$3,000.....	160	180	178
\$4,000.....	260	405	400
\$5,000.....	560	630	622
\$6,000.....	760	855	844
\$7,000.....	1,416	1,593	1,571
\$8,000.....	1,888	2,124	2,096
\$9,000.....	3,260	3,069	3,618
\$10,000.....	4,872	5,481	5,408
\$15,000.....	6,724	7,565	7,400
\$20,000.....	19,592	22,041	21,744
\$25,000.....	52,776	59,373	56,468
\$30,000.....	222,572	244,161	228,694
\$35,000.....	403,548	433,161	411,314
\$1,000,000.....	858,548	2,900,000	869,814

MARRIED COUPLE, 2 DEPENDENTS

\$3,000.....			
\$4,000.....	\$120	\$135	\$133
\$5,000.....	320	360	355
\$6,000.....	520	585	577
\$7,000.....	1,152	1,296	1,278
\$8,000.....	1,592	1,791	1,766
\$9,000.....	2,900	3,263	3,222
\$10,000.....	4,404	5,022	4,952
\$15,000.....	6,268	7,052	6,955
\$20,000.....	18,884	21,245	20,961
\$25,000.....	51,912	58,401	55,592
\$30,000.....	221,504	243,027	227,581
\$35,000.....	402,466	432,027	410,241
\$1,000,000.....	857,466	2,900,000	868,741

¹ Maximum effective rate limitation of 87 percent.² Maximum effective rate limitation of 90 percent.³ Maximum effective rate limitation of 88 percent.

2. Reasons for the rate changes

Your committee believes that in view of revenue requirements resulting from the present national defense emergency it is necessary to make substantial increases in the individual income taxes. Only by such increases will it be possible to come close to balancing the budget and alleviating the impact of increased inflationary pressures arising from additional defense expenditures. It is believed, however, that the 12½-percent increase in present taxes provided by the House

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bill is too severe in view of the fact that an average increase of 17 percent in individual income taxes has been made quite recently by the Revenue Act of 1950. For that reason your committee has reduced this percentage increase for the bulk of the taxpayers to 11 percent of their present taxes. Even with this increase many taxpayers will find themselves with tax rates in excess of the peak rates imposed during World War II.

Your committee modified this 11-percent increase by providing that in no case is the increase to be more than about 8 percent on the income remaining after taxes. Your committee believes that a provision of this type is fairer to all income groups than the type of provision adopted by the House. For most taxpayers their present tax is much smaller than their income remaining after the payment of taxes. However, because of the present highly progressive income tax rates for some taxpayers, their income remaining after the payment of all taxes is smaller than their present tax burden. In the case of both of these groups of taxpayers, your committee's bill imposes an increase on the smaller amount; in the case of the former group, on the present tax burden, and in the case of the latter group, on the income remaining after payment of the present tax burden. The percentage increase in income after taxes is effective with respect to taxable incomes of about \$27,000 and over. It was believed necessary to provide a limitation of this type, in view of the fact that in the upper income brackets the marginal rates, or the rates applying to the next dollar of income, are already very high. The present law marginal tax rate at \$28,000 of surtax net income, for example, is 62 percent; at \$44,000 is 72 percent; at \$70,000 is 81 percent; and at \$200,000 is 91 percent. Your committee's bill raises these marginal rates very substantially, although not as much as the 12½-percent increase provided by the House. In the view of your committee, the marginal rate of about 70 percent provided on surtax net income of \$28,000 under the House bill will seriously impair the incentives of the taxpayers in this bracket to work and to invest. Still more drastic is the marginal rate of nearly 85 percent provided by the House bill on incomes of \$50,000, and the rate of 94.5 percent provided for incomes of \$80,000. The rates provided by your committee's bill in these brackets also are drastic but less so than those of the House bill. Under your committee's bill the marginal rate at \$28,000 is 67 percent; at \$44,000 is 73 percent; at \$70,000 is 82 percent; and at \$200,000 is 91.7 percent.

A similar limitation on the tax increase was previously provided in the Victory tax imposed by the Revenue Act of 1942. That tax was limited to the excess of 90 percent of net income after the regular income tax liability. The 1940 defense tax also used this type of formula. Your committee believes that in bracket areas where the progression is already quite steep the formula used in imposing additional taxes should measure ability to pay by taking into consideration taxes already paid. It is only the funds remaining after the payment of the present tax burden which such individuals will have available to meet additional tax burdens.

Although the House bill increases the alternative tax on capital gains to a little over 28 percent, your committee's bill retains the ceiling rate in this tax at 25 percent. Your committee recognizes that capital gains are different from ordinary income in that the time of

realizing a capital gain, to a substantial degree, is subject to the control of the taxpayer. Therefore, in this case, particularly, high rates tend to discourage the realization of gains. Congress has recognized this as far back as the Revenue Act of 1942 by placing an effective ceiling rate of 25 percent on capital gains income. Since that time, although individual income tax rates have been both substantially increased and decreased, this ceiling rate has remained the same. In view of this your committee does not believe that it is appropriate to consider a change in this ceiling rate at this time.

A termination date, namely, December 31, 1953, has been provided by your committee for the individual income tax rate increases because it is recognized that these rates are exceedingly high, and your committee hopes that it will be unnecessary to continue rates at this high level after December 31, 1953. In any case, it appears desirable to review the levels of the individual income tax rates at that time.

November 1, 1951 was selected as the effective date for the individual income tax increases because so much of the individual income tax is collected through the withholding system that it is not feasible to make changes in this tax applicable prior to the time the withholding rate increases can be made. Because some time will be required for the preparation of the new withholding tax tables and their distribution to employers, November 1 appears to be the earliest possible date at which withholding can be made effective. The September 1 date contained in the House bill was selected before it was known how much time would be required for the proper consideration for this tax measure.

Your committee has included the increase provided by its bill in the regular surtax rate schedule because it is believed that this will be easier for both the taxpayers and the administrators. The report of the Committee on Ways and Means of the House indicates that the rate increase provided by the House bill was not included in the rate schedule because it was believed that a separate schedule would be more generally recognized as representing a temporary tax increase. Your committee agrees with this objective, but believes that it is better accomplished by the termination date for the individual income tax increases as provided in its bill. Therefore, it was believed unnecessary to retain the increase made by your committee as a separate computation.

B. HEAD-OF-HOUSEHOLD PROVISION

1. Description

For persons qualifying as a "head of a household" your committee's bill provides a new surtax table applicable for taxable years beginning after October 31, 1951 and the House bill, for taxable years beginning after August 31, 1951. Thus, in both cases, for a calendar year taxpayer, the provision will not become effective until 1952. In your committee's bill the new surtax table is constructed to give heads of households approximately one-quarter of the benefits of income-splitting, while the surtax table in the House bill provides them approximately one-half of these benefits.

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Your committee's bill defines a head of a household, for purposes of obtaining the benefits of this special provision, as an individual who is not married and who maintains a household in which lives—

(1) One of his children (including an adopted child), one of their descendants or a stepchild (but the child, descendant, or stepchild if married must still be a dependent of the taxpayer and not file a joint return); or

(2) Any person (not filing a joint return with a spouse), who has a gross income of less than \$600,⁵ more than half of whose support is supplied by the taxpayer and who bears one of the following relationships to the taxpayer:

- (a) A brother or sister or stepbrother or stepsister,
- (b) A parent or one of their ancestors,
- (c) A stepparent,
- (d) A nephew or niece,
- (e) An uncle or aunt, or
- (f) A son-in-law, daughter-in-law, mother-in-law, father-in-law, sister-in-law, or brother-in-law.

The House bill differs only in one minor respect in the tests outlined above. In the House bill the descendants of stepchildren are included among the relatives who if living in the household of a taxpayer may make him eligible for the head-of-household status.

Under both bills, a taxpayer is considered as maintaining a household only if during the year he furnishes more than half the maintenance costs of such household. Moreover, the individual who makes it possible for the taxpayer to gain the benefits of the head-of-household status must actually live in the taxpayer's household during the entire taxable year unless he is temporarily absent, for example, attending school or for reasons of health. Under this definition it is immaterial how much gross income an unmarried child or grandchild living with the taxpayer may have.

Table 3 shows for both the House bill and your committee's bill the amount of tax paid at selected net income levels for heads of households with one dependent, for single individuals with one dependent, and for married couples with no dependents. It also shows how much less the tax of the head of household and the tax of the married couple are than that of the single person at the same income level. This represents the benefits of income splitting which present law grants in full to married couples and which both the House and your committee's bill grant in part to heads of households. The last column of the table expresses the income-splitting benefits granted heads of households as percentages of the income-splitting benefits available to married couples. This shows that your committee's bill grants about 25 percent, and the House bill about 50 percent, of the benefits of income splitting to heads of households.

⁵ Under present law the taxpayer is allowed a dependency credit provided the dependent has a gross income of less than \$500. Sec. 310 of your committee's bill, discussed elsewhere in this report, raises the allowable gross income of a dependent to \$600.

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TABLE 3.—Comparison of individual income tax burdens for heads of households under the House bill and your committee's bill with those for single persons with 1 dependent and for married couples under both bills, for 1952

A. HOUSE BILL

Selected net income levels ¹	Amount of tax			Amount of tax difference between single person with 1 dependent and—		Percent tax difference of head of household is of that of married couple
	Head of household with 1 dependent	Single individual with 1 exemption	Married couple filing a joint return	Head of household	Married couple	
\$1,500.....	\$68	\$68	\$68			
\$2,000.....	180	180	180			
\$3,000.....	405	405	405			
\$5,000.....	875	896	855	\$21	\$41	51.2
\$8,000.....	1,697	1,800	1,593	103	207	49.8
\$10,000.....	2,318	2,511	2,124	193	387	49.9
\$15,000.....	4,172	4,696	3,688	524	1,028	51.0
\$20,000.....	6,462	7,452	5,481	990	1,971	50.2
\$25,000.....	9,092	10,622	7,565	1,530	3,057	50.0
\$50,000.....	25,605	29,201	22,041	3,596	7,160	50.2
\$100,000.....	66,830	74,264	59,373	7,434	14,891	49.9
\$500,000.....	442,724	² 460,000	433,161	7,276	16,839	43.2
\$1,000,000.....	³ 900,000	² 900,000	³ 900,000			

B. COMMITTEE BILL

\$1,500.....	\$67	\$67	\$67			
\$2,000.....	178	178	178			
\$3,000.....	400	400	400			
\$5,000.....	872	883	844	\$11	\$39	28.2
\$8,000.....	1,728	1,776	1,571	48	205	23.4
\$10,000.....	2,388	2,476	2,096	88	380	23.2
\$15,000.....	4,372	4,636	3,618	264	1,018	25.9
\$20,000.....	6,872	7,364	5,408	492	1,956	25.2
\$25,000.....	9,722	10,482	7,460	760	3,022	25.1
\$50,000.....	26,288	27,796	21,744	1,508	6,052	24.9
\$100,000.....	65,732	68,816	56,468	3,084	12,348	25.0
\$500,000.....	428,890	434,372	411,344	5,482	23,028	23.8
\$1,000,000.....	³ 880,000	³ 880,000	869,844		10,156	

¹ Income after deductions but before exemptions.

² Maximum effective rate limitation of 90 percent.

³ Maximum effective rate limitation of 88 percent.

2. Reasons for adopting the head-of-household provision

Your committee agrees with the House that taxpayers, not having spouses but nevertheless required to maintain a household for the benefit of other individuals, are in a somewhat similar position to married couples who, because they may share their income, are treated under present law substantially as if they were two single individuals each with half of the total income of the couple. The income of a head of household who must maintain a home for a child, for example, is likely to be shared with the child to the extent necessary to maintain the home and raise and educate the child. This, it is believed, justifies the extension of some of the benefits of income splitting. The hardship appears particularly severe in the case of the individual with children to raise who, upon the death of his spouse, finds himself in the position not only of being denied the spouse's aid in raising the children, but under present law also may find his tax load much heavier.

As indicated by the report of the Committee on Ways and Means of the House it does not appear appropriate to give a head of household the full benefits of income splitting because it is unlikely that there is

as much sharing of income in these cases as between spouses. Moreover, it is your committee's opinion that in view of the fact that under the head-of-household provision taxpayers are not required to include the income of the dependent (spouses must file a joint return in order to enjoy the benefits of income splitting) an allowance of 25 percent of the benefits of income splitting for such taxpayers should be adequate.

In defining the relationship to the taxpayer of an individual who enables the taxpayer to claim the head-of-household status, the relationships provided in section 25 (b) (3) of the code for claiming a dependency credit have been followed. In all cases except those in which unmarried children, their descendants or stepchildren live in the home of the taxpayer he must supply over half of the support of the relative and the relative must have gross income of less than \$600.⁶ These limitations are believed to be unnecessary in the case of children, grandchildren, or stepchildren because such relatives are ordinarily a part of the close family unit and the relationship is more nearly similar to that existing between spouses than is true in the other cases. However, even such individuals must live in the same household as the taxpayer, except for the temporary absences previously described, and the taxpayer must supply over half the cost of maintaining the household. However, the limitations described in section 25 (b) (3) are applied where the children or grandchildren are married. This will prevent extending the benefits of a head of household to a parent while the child is himself obtaining the benefits of income splitting with his spouse.

C. DISTRIBUTION OF TAX BURDEN

Table 4 shows the distribution of the individual income tax burden under present law, the House bill and your committee's bill by adjusted gross income classes.⁷ It also distributes by the same classes the number of taxable returns, the adjusted gross income, the value of the exemptions and the normal tax and surtax net income.⁸

The table indicates that of \$25,823 million in total individual income tax liability under your committee's bill, \$9,637 million will come from those with adjusted gross incomes of \$5,000 or less and \$16,186 million from those with adjusted gross incomes of over \$5,000.

⁶ See footnote 4 above.

⁷ Income after business but before personal deductions and exemptions.

⁸ Income after business and personal deductions and exemptions.

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TABLE 4.—*Estimated distribution of individual income-tax returns, income, exemptions, and tax liability under present law, House bill, and Finance Committee bill when fully effective*

[Money amounts in millions of dollars]

Adjusted gross income classes	Total number of returns	Adjusted gross income	Value of exemptions	Surtax net income	Total tax, present law ¹	Total tax under House bill ¹	Total tax under Finance Committee bill ¹
Under \$1,000.....	1,868,095	\$1,556	\$1,121	\$272	\$54	\$61	\$60
\$1,000 to \$2,000.....	6,991,074	10,875	5,436	4,209	842	947	934
\$2,000 to \$3,000.....	10,908,014	27,275	12,918	11,226	2,245	2,526	2,492
\$3,000 to \$4,000.....	9,830,797	33,462	15,496	14,315	2,871	3,229	3,186
\$4,000 to \$5,000.....	6,262,777	27,905	11,259	13,247	2,672	3,002	2,964
Total under \$5,000.....	35,860,757	101,073	46,230	43,268	8,684	9,765	9,637
\$5,000 to \$10,000.....	6,645,679	42,850	12,524	24,916	5,080	5,707	5,635
\$10,000 to \$25,000.....	1,342,865	19,470	2,637	14,742	3,488	3,905	3,864
\$25,000 to \$50,000.....	247,141	8,200	495	6,970	2,289	2,560	2,520
\$50,000 to \$100,000.....	70,115	4,675	138	3,966	1,862	2,086	2,026
\$100,000 to \$250,000.....	18,276	2,559	35	1,966	1,276	1,420	1,341
\$250,000 to \$500,000.....	1,967	647	3	438	378	418	388
\$500,000 to \$1,000,000.....	479	316	1	185	192	209	195
\$1,000,000 and over.....	189	310	(²)	178	206	219	208
Total over \$5,000.....	8,326,711	79,027	15,833	53,363	14,771	16,537	16,186
Total.....	44,187,468	180,100	62,063	96,631	23,455	26,302	25,823

¹ Includes normal tax, surtax, and alternative tax on net long-term capital gains.² Less than \$500,000.

NOTE.—Figures are rounded and may not add to totals.

IV. GENERAL CORPORATE TAX CHANGES

Both your committee's bill and the House bill provide a top corporate rate of 52 percent as contrasted to 47 percent under existing law. Your committee's bill provides a corporate income tax rate of 27 percent on the first \$25,000 of each corporation's income, and a 52-percent rate on all income in excess of \$25,000. This can be compared with House bill rates of 30 percent on the first \$25,000 of income, and 52 percent on all income in excess of \$25,000. Under existing law the first \$25,000 of each corporation's income is taxed at 25 percent and all income in excess of this amount is taxed at 47 percent. Under both your committee's bill and the House bill the top corporate income tax rate, taken together with the 30 percent excess profits tax rate, gives a combined rate of 82 percent applying to adjusted excess profits net income, as compared with a combined rate of 77 percent under existing law. Your committee's bill provides a ceiling rate of 17 percent for excess profits tax and consolidated return purposes, which when taken together with the maximum effective rate of about 52 percent under the corporate income tax, means that in no case will more than about 69 percent of a corporation's income be taken in income, consolidated return and excess profits taxes. The House bill provides a ceiling rate on income taxes and excess profits taxes, taken together, of 70 percent, and present law provides a 62 percent ceiling of this type. The normal tax and surtax rate changes provided by your committee's bill are effective as of April 1, 1951, and are to terminate as of December 31, 1953. The House bill sets January 1, 1951, as the effective date but has no termination provision.

It is estimated that in a full year of operation these changes in corporate rates will increase liabilities by \$2,220 million before

consideration is given to the effect on individual income taxes of the smaller amounts which will be available for corporation dividend payments. Of this amount, \$2,100 million is attributable to the increases in the regular corporate income taxes. The additional \$120 million is attributable to increases in excess profits tax liabilities. It is estimated that after the decrease in individual income tax collections resulting from smaller dividend payments is taken into account, the net increase provided by the actions of your committee with respect to corporate rates will be \$2,060 million. The House bill provided a gross increase in corporate tax liabilities of \$3,078 million and a net increase of \$2,855 million.

In the fiscal year 1952, ending June 30, 1952, it is estimated that the increases in corporate rates provided by your committee's bill will increase revenues in this year by \$870 million as compared with \$1,740 million under the House bill.

A. NORMAL TAX AND SURTAX RATE CHANGES

Your committee's bill provides a corporate normal tax rate of 27 percent as compared to 25 percent under existing law, and 30 percent under the House bill. The corporate surtax rate under your committee's bill is 25 percent as compared to 22 percent under both existing law and the House bill. Changes are also provided in both your committee's and the House bills in the credits allowed Western Hemisphere trade corporations and the credits for dividends paid and received on preferred stock of public utilities, in order to retain the tax differential provided in these cases under existing law.

Since corporations with incomes of \$25,000 or less are subject only to the normal tax, their rate of tax is increased from 25 percent to 27 percent under your committee's bill, or by 3 percentage points less than is provided by the House bill. The combined normal tax and surtax on incomes in excess of \$25,000 is increased from 47 percent to 52 percent by your committee's action, the same increase as is provided by the House bill. Table 5 compares for corporations with selected net incomes the combined corporate normal tax and surtax effective rates under your committee's bill with those under the House bill, under existing law and under the law in effect prior to the enactment of the Revenue Act of 1950. The table indicates that under your committee's provisions the effective rate, or average rate on the entire taxable income, for corporations with incomes of \$25,000 or less, is always 2 percentage points above existing law and 3 percentage points below the House bill. For corporations with incomes above \$25,000 the percentage point increase provided by your committee as the income grows larger gradually approaches, but never quite reaches, a 5-percentage-point increase over existing law. Or, expressing it another way, the increase provided by your committee's bill never quite reaches the increase provided by the House bill. This is attributable to the fact that your committee did not place the full 5-percentage-point increase on the normal tax with respect to which corporations are fully taxable, but rather added 3 of the additional 5 percentage points to the surtax with respect to which corporations have a \$25,000 exemption.

Table 6 shows for corporations with selected net incomes the combined corporate normal tax and surtax liabilities under your com-

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mittee's bill, under the House bill, under existing law, and under the law in effect prior to the enactment of the Revenue Act of 1950. The increase in tax liabilities of your committee's bill over existing law ranges in the cases shown from 8 percent on incomes under \$25,000, to 10.64 percent on incomes of \$100,000,000. Under the House bill the increase in tax liabilities ranges in the cases shown from 20 percent of the tax due under present law on incomes under \$25,000, to 10.64 percent on incomes of \$100,000,000. Thus under your committee's bill the percentage increase in tax grows larger as the income increases, while under the House bill exactly the reverse is true.

The rate increases provided by your committee's bill are much larger than it would ordinarily be desirable to provide, and it is realized that if corporate rates are continued at this high level indefinitely the expansion of productive facilities may be seriously impaired. For this reason your committee has set December 31, 1953, as the termination date for these increases. In the interval before 1953, your committee believes that corporations will be able to stand these high rates in view of the high corporate profits stemming in a large part from the national defense program and the high level of demand generally for products and services. In the first quarter of 1951 corporate profits before taxes were running at the annual rate of nearly \$52 billion, and in the second quarter of 1951 it is estimated that corporate profits were running at the annual rate of \$48½ billion. Thus, corporate profits in the first half of 1951 are above the very high rates reached in the last half of 1950 and one-half again as large as the profits in the calendar year 1948, which were the largest prior to 1950. It is expected that corporate profits after all taxes, even including the taxes imposed by your committee's bill, will be within about \$2.5 billion of the level of corporate profits after taxes in 1950 and above the profits after taxes in any prior year except 1948. During World War II, for example, corporate profits after taxes ranged from \$8.5 billion to \$10.8 billion as compared to anticipated corporate profits of about \$20 billion after the taxes imposed under your committee's bill.

TABLE 5.—Comparison of corporate combined normal tax and surtax effective rates under present law, House bill and Senate Finance Committee bill

Net income subject to normal tax and surtax	Effective rates of combined normal tax and surtax (percent)				Percentage point increase over present law	
	Pre-1950	Present law	House bill	Finance Committee bill	House bill	Finance Committee bill
\$1,000.....	21.00	25.00	30.00	27.00	5.00	2.00
\$5,000.....	21.00	25.00	30.00	27.00	5.00	2.00
\$10,000.....	22.00	25.00	30.00	27.00	5.00	2.00
\$25,000.....	23.00	25.00	30.00	27.00	5.00	2.00
\$30,000.....	28.00	28.67	33.67	31.17	5.00	2.50
\$40,000.....	34.25	33.25	38.25	36.38	5.00	3.13
\$50,000.....	38.00	36.00	41.00	39.50	5.00	3.50
\$60,000.....	38.00	37.83	42.83	41.58	5.00	3.75
\$75,000.....	38.00	39.67	44.67	43.67	5.00	4.00
\$100,000.....	38.00	41.50	46.50	45.75	5.00	4.25
\$200,000.....	38.00	44.25	49.25	48.88	5.00	4.63
\$500,000.....	38.00	45.90	50.90	50.75	5.00	4.85
\$1,000,000.....	38.00	46.45	51.45	51.38	5.00	4.93
\$10,000,000.....	38.00	46.95	51.95	51.94	5.00	4.99
\$100,000,000.....	38.00	46.99	51.99	51.99	5.00	5.00

¹ This percentage is rounded. It actually is just under 5 percent.

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TABLE 6.—Comparison of corporate normal tax and surtax liabilities under pre-1950 law, present law, House bill, and Finance Committee bill

Net income subject to normal tax and surtax	Combined normal tax and surtax				Increase in tax liability over present law			
					Amount		Percent	
	Pre-1950	Present law	House bill	Finance Committee bill	House bill	Finance Committee bill	House bill	Finance Committee bill
\$1,000.....	\$210	\$250	\$300	\$270	\$50	\$20	20.00	8.00
\$5,000.....	1,050	1,250	1,500	1,350	250	100	20.00	8.00
\$10,000.....	2,200	2,500	3,000	2,700	500	200	20.00	8.00
\$25,000.....	5,750	6,250	7,500	6,750	1,250	500	20.00	8.00
\$30,000.....	8,400	8,600	10,100	9,350	1,500	750	17.44	8.72
\$40,000.....	13,700	13,300	15,300	14,550	2,000	1,250	15.04	9.40
\$50,000.....	19,000	18,000	20,500	19,750	2,500	1,750	13.89	9.72
\$60,000.....	22,800	22,700	25,700	24,950	3,000	2,250	13.22	9.91
\$75,000.....	28,500	29,750	33,500	32,750	3,750	3,000	12.61	10.08
\$100,000.....	38,000	41,500	46,500	45,750	5,000	4,250	12.05	10.24
\$200,000.....	76,000	88,500	98,500	97,750	10,000	9,250	11.30	10.45
\$500,000.....	190,000	229,500	254,500	253,750	25,000	24,250	10.89	10.57
\$1,000,000.....	380,000	464,500	514,500	513,750	50,000	49,250	10.76	10.60
\$10,000,000.....	3,800,000	4,694,500	5,194,500	5,193,750	500,000	499,250	10.65	10.63
\$100,000,000.....	38,000,000	46,994,500	51,994,500	51,993,750	5,000,000	4,999,250	10.64	10.64

Moreover, these larger tax collections during the immediate period ahead will occur during a period of large defense orders and a high level of consumer income. The assurance of these large and predictable markets for producers during the immediate period ahead must be offset against the adverse effect on incentives of the high corporate taxes provided by this bill.

Your committee deems it desirable to add only two out of the five percentage points by which corporate taxes are increased to the normal tax because this is the only rate under which some small corporations are taxed and the rate under which most of the income of other relatively small corporations is taxed. Your committee believes that the continuance of a free competitive market demands the creation of new, and the growth of existing, small businesses and that this necessitates preferential tax treatment with today's corporate tax burden.

B. CEILING RATE OR MAXIMUM RATE LIMITATION

Under existing law the normal tax, surtax, 2-percent tax on consolidated returns, and excess profits tax together may not exceed 62 percent of a corporation's excess profits net income (income before deducting the excess profits credit and unused excess profits credit carry-over.⁹ Thus, for corporations with effective income tax rates of about 47 percent, this means that the excess profits tax may not exceed about 15 percent of their excess profits net income.

Under the House bill this ceiling rate, or maximum rate limitation, is raised to 70 percent, or by 8 percentage points. Five of these percentage points merely offset the 5-percentage-point increase in the income tax rates in the case of the corporation with most of

⁹ For this purpose the excess profits net income is substituted for the normal tax net income and surtax net income in computing the various taxes involved. Excess profits net income is income before the deduction of the excess profits tax credit and the excess profits credit carry-over. The 30 percent excess profits tax rate is applied to adjusted excess profits net income—that is, excess profits net income after deduction of the excess profits credit and the unused excess profits credit carry-over.

its income taxed at the 52-percent rate. The additional 3-percent-age-point increase in the ceiling rate provided by the House bill, however, has the effect of increasing the excess profits tax liabilities of many corporations. The 70-percent ceiling rate for a corporation with an effective income tax rate of about 52 percent means that its excess profits tax may not exceed about 18 percent of its excess profits net income under the House bill as contrasted to 15 percent under existing law.

Your committee's bill adopts a new type of ceiling rate. The ceiling rate in this bill is 17 percent of excess profits net income but applies only with respect to excess profits tax liability and the tax liability on consolidated returns. For corporations with income tax effective rates of about 52 percent this is the equivalent of about a 69-percent ceiling rate on liabilities under the income taxes, consolidated return tax and excess profits tax, taken together, and this is the rate which is comparable in these cases to the 70-percent ceiling rate under the House bill and the 62-percent ceiling rate under existing law. However, because of the \$25,000 surtax exemption, the effective income tax rates of corporations with taxable incomes of less than \$300,000 is less than 50 percent. As a result a ceiling rate of 69 percent on their combined income and excess profits liabilities is quite different from a 17-percent ceiling on their excess profits tax liabilities. Table 7 shows for selected income levels, the effective income tax rates under your committee's bill, and the maximum effective rates with the 69-percent ceiling formula and the 17-percent ceiling formula. The table indicates that for corporations with incomes over \$58,000¹⁰ the 17-percent formula is the more generous, resulting in a maximum tax saving of nearly 6 percent of total income for corporations with incomes of about \$106,000.

¹⁰ For corporations with incomes under \$57,692.31 the \$25,000 minimum excess profits tax credit prevents a higher effective rate than 17 percent under both formulas.

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TABLE 7.—Corporation normal tax and surtax effective rates under the Finance Committee bill, and a comparison of the maximum effective rates of income and excess-profits taxes under a 69-percent ceiling rate on income and excess-profits taxes with the ceiling rate under the Senate Finance Committee bill (a 17-percent ceiling rate on excess-profits taxes alone)

Current income	Effective rate of normal tax and surtax under Finance Committee bill	Maximum effective rate of income and excess-profits taxes		
		69 percent income and excess-profits ceiling	17 percent excess-profits tax ceiling (provided by bill)	Percentage point difference
	Percent	Percent	Percent	Percent
\$10,000.....	27.00	¹ 27.00	² 27.00	-----
\$25,000.....	27.00	¹ 27.00	² 27.00	-----
\$30,000.....	31.17	¹ 36.17	² 36.17	-----
\$40,000.....	36.38	¹ 47.63	² 47.63	-----
\$50,000.....	39.50	¹ 54.50	² 54.50	-----
\$57,692.....	41.17	¹ 58.17	² 58.17	-----
\$60,000.....	41.68	¹ 59.08	58.58	0.50
\$70,000.....	43.07	¹ 62.36	60.07	2.29
\$80,000.....	44.19	¹ 64.81	61.19	3.62
\$90,000.....	45.06	¹ 66.72	62.06	4.66
\$100,000.....	45.75	¹ 68.25	62.75	5.50
\$105,789.....	46.09	69.00	63.00	5.91
\$150,000.....	47.83	69.00	64.83	4.17
\$200,000.....	48.88	69.00	65.88	3.12
\$250,000.....	49.50	69.00	66.50	2.50
\$300,000.....	49.92	69.00	66.92	2.08
\$400,000.....	50.44	69.00	67.44	1.56
\$500,000.....	50.75	69.00	67.75	1.25
\$1,000,000.....	51.38	69.00	68.38	.62
\$10,000,000.....	51.94	69.00	68.94	.06
\$100,000,000.....	51.99	69.00	68.99	.01

¹ As a result of the \$25,000 surtax exemption and the \$25,000 minimum credit, the maximum effective rate on income and excess-profits tax liabilities is always less than 69 percent for corporations with incomes below \$105,789.23.

² As a result of the \$25,000 minimum excess-profits-tax credit, the maximum effective excess-profits tax rate for corporations with incomes below \$57,692.31 is always less than 17 percent.

Your committee prefers this ceiling on excess-profits-tax liabilities over the type of ceiling rate in present law and the House bill because this type of ceiling rate is more advantageous to small corporations. Moreover, even for large corporations this 17-percent ceiling rate provides a maximum effective rate on total liabilities which is never quite 69 percent as compared to the flat 70-percent ceiling provided under the House bill. Although the large corporations subject to this maximum rate necessarily have substantially larger earnings than their excess-profits-tax credit would suggest is "normal," this lower maximum rate is deemed desirable because imperfections in the present allowable methods of computing the excess-profits credit may substantially understate "normal" earnings.

C. CAPITAL-GAINS TAX RATE

The House bill increased the capital-gains tax rate for corporations from 25 to 28.125 percent. This is an increase of 12½ percent, which corresponds with the 12½-percent increase made by the House bill in the capital-gains tax rate of individuals. Since your committee's bill provides no increase in the maximum capital-gains tax rate of individuals, no increase is made in the capital-gains tax rate of corporations. Under the House bill it was estimated that the rate increase in capital gains would increase corporate tax liabilities by \$38 million before taking into account the reduction in corporate dividend payments.

D. PERCENTAGE OF THE AVERAGE BASE PERIOD NET INCOME TAKEN INTO ACCOUNT IN COMPUTING THE EXCESS-PROFITS CREDIT

Under present law a corporation in computing its excess-profits credit on the basis of average earnings may take into account only 85 percent of its average earnings in its three best years in the period 1946-49. The House bill reduces this percentage to 75 percent, but your committee's bill keeps it at 85 percent.

After studying this point last year in its consideration of excess profits tax legislation, your committee concluded that a 15-percent discount was an adequate adjustment in order to place 1946-49 earnings on a normal basis and your committee believes a greater discount cannot be sustained. To further reduce this 85 percent in the case of the average-earnings base is to penalize those using this type of credit instead of the invested capital credit. It should not be forgotten that in the World War II excess-profits tax the average earnings in the base period was only reduced by 5 percent.

E. EFFECTIVE DATE

Under your committee's bill the corporate rate increases are effective as of April 1, 1951. Under the House bill they are effective as of January 1, 1951. Your committee generally is opposed to making retroactive rate increases and for this reason did not accept the House effective date of January 1. However, the need for revenue in the fiscal year 1952 made it necessary for your committee to apply these rate increases as far back as April 1 of this year. By making these corporate rate increases effective at that time it is anticipated that collections in the fiscal year 1952 (before taking into account the effect of smaller dividends on individual income tax collections) will be increased by \$975 million as contrasted to only \$615 million if, for example, the corporate rate changes were not made effective until July 1, or \$295 million if the rate changes were made effective as of October 1. Moreover, by making the rate increase effective as of January 1, the House bill increases the tax of most corporations even before they have paid any of the additional taxes resulting from the increases made by the Revenue Act of 1950. Thus, for a calendar year corporation, for example, the top corporate rate would jump from 42 percent in 1950 to 52 percent in 1951. This is an increase of about 24 percent, and your committee considers it too steep an increase to be made with respect to a single year. By making the increase effective as of April 1, your committee's bill spreads the full 24 percent increase over 2 years instead of 1. It should also be noted that for the bulk of the corporations, which are on a calendar-year basis, the Government will not begin collecting this additional 1951 tax liability until March 1952 and will not complete its collection until December 1952. Thus, corporations will have adequate time in which to prepare for these additional tax payments.

The corporate income tax and ceiling rate changes provided by your committee's bill are to be effective with respect to taxable years beginning after March 31, 1951. For corporations with taxable years beginning prior to July 1, 1950, and ending after March 31, 1951, your committee's bill provides a formula for prorating the taxes due under the law in effect prior to the Revenue Act of 1950, under existing law

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and under your committee's bill. For corporations with taxable years beginning after June 30, 1950, and ending after March 31, 1951, your committee's bill prorates the taxes due under existing law and under your committee's bill. In general these proration formulas provide that the tax on the entire income is to be computed at the two or three different rates applicable. Then these taxes are multiplied by a fraction of which the numerator is the number of days in the corporation's taxable year in which the rate in question is effective, and the denominator is the total number of days in its taxable year. The sum of these fractional taxes is the corporation's final obligation.

F. DISTRIBUTION OF THE BURDEN

Table 8 shows the combined corporate income and excess profits tax liabilities of corporations in various income classes under existing law, under the House bill and under your committee's bill. The table indicates that of the 415,182 corporations with taxable net income, 292,491, or about 70 percent of the total, have incomes of less than \$25,000. These corporations which have 4.8 percent of the total taxable income, bear 3.55 percent of the increase in tax liabilities provided by the House bill, but only 1.94 percent of the increase in tax liabilities under your committee's bill. The 45,022 corporations with incomes of \$100,000 and over, which constitute about 11 percent of the total number of corporations with taxable net income, have 87.25 percent of the total taxable income, and would bear 89.34 percent of the increase provided by the House bill, or 92.37 percent of the increase provided by your committee's bill.

TABLE 8.—Estimated corporate income and excess profits tax liabilities under present law, the House bill and the Finance Committee bill, calendar year 1951¹

Taxable net income classes	Number of taxable returns	Taxable net income	Income and excess profits tax liabilities			Increase over present law	
			Present rates	House bill	Finance Committee bill	House bill	Finance Committee bill
		Millions	Millions	Millions	Millions	Millions	Millions
Up to \$25,000.....	292,491	\$2,161	\$540	\$548	\$583	\$108	\$43
\$25,000 to \$50,000.....	47,192	1,566	520	608	563	88	43
\$50,000 to \$100,000.....	30,477	2,018	869	1,027	982	128	83
\$100,000 and over.....	45,022	39,311	21,426	24,142	23,473	2,716	2,047
Total.....	415,182	45,056	23,385	26,425	25,601	3,040	2,216
Percent distribution							
Up to \$25,000.....	70.45	4.80	2.31	2.45	2.28	3.55	1.94
\$25,000 to \$50,000.....	11.37	3.47	2.22	2.30	2.20	2.90	1.94
\$50,000 to \$100,000.....	7.34	4.48	3.85	3.89	3.84	4.21	3.75
\$100,000 and over.....	10.84	87.25	91.62	91.36	91.68	89.34	92.37
	100.00	100.00	100.00	100.00	100.00	100.00	100.00

¹ Based upon a level of profits before tax (Commerce basis) of \$48 billion.

V. TAX-EXEMPT ORGANIZATIONS

Your committee's bill imposes the regular corporate income tax on certain undistributed profits of the following organizations fully exempt from income tax under section 101 of the present law: farmers' purchasing and marketing cooperatives, mutual savings banks, and State chartered savings and loan associations, as well as Federal savings and loan associations. A minor amendment is also provided in the case of educational bodies with respect to their "feeder" organizations. This provision is in the House bill. With respect to mutual casualty and fire insurance companies, presently subject to limited taxation, the staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation have been requested to prepare a report on their tax treatment, and your committee will give consideration to this matter as soon as is feasible after the completion of that report.

The House bill does not go into the subject of tax treatment of cooperatives or mutual financial institutions. As a result the \$150 million which it is anticipated will be derived from the tax treatment provided in your committee's bill for these organizations represents an increase not only in the amount collected under present law but in the amount which would be collected under the House bill.

A. COOPERATIVES

Section 101 (12) of the code exempts from income tax all farm cooperatives which meet certain specified requirements. This exemption includes not only cooperatives marketing the products of farmers but also cooperatives purchasing products and reselling them to farmers. The chief requirements which must be met by cooperatives in order to be exempt from income tax under section 101 (12) are as follows:

1. They must be farmers', fruit growers', or like associations organized and operated on a cooperative basis for the purpose of marketing products or purchasing supplies for their members.
2. Substantially all of their stock (other than preferred non-voting stock) must be owned by producers marketing products or purchasing supplies through the cooperatives.
3. The marketing of products of nonmembers may not exceed 50 percent in value of the cooperative's total marketing.
4. The purchasing for nonmembers may not exceed 50 percent of the cooperative's total purchasing, and the purchasing for persons who are neither members nor producers may not exceed 15 percent of the cooperative's total purchasing.
5. Nonmembers must not be discriminated against in the allocation of patronage dividends or refunds to the accounts of patrons.

At the present time, the advantages which are derived from exemption can be summarized as follows: First, the earnings of a cooperative which are paid out to shareholders in the form of dividends on capital stock are not taxable to an exempt cooperative but are taxable to other cooperatives. Second, any part of the net margins or profits which are retained as reserves and not allocated to the accounts of patrons are not taxable to an exempt cooperative but are taxable in the case of other cooperatives. Third, nonoperating income such as interest, dividends,

rents, and capital gains and also the income from certain business done with the United States Government or its agencies, is taxable to the ordinary cooperative even when allocated to the accounts of patrons, but are tax-free to the exempt cooperative whether or not allocated.

Section 314 of your committee's bill continues the exemption provided by section 101 (12) of the code but removes from its application earnings which are placed in reserves or surplus and not allocated or credited to the accounts of patrons. In addition to being tax-free with respect to patronage dividends paid or allocated to patrons, as is generally also true in the case of other cooperatives, the cooperatives coming under section 101 (12) are also to remain exempt with respect to amounts paid as dividends on capital stock, and with respect to amounts allocated to patrons where the income involved was not derived from patronage, as for example in the case of interest or rental income, and income derived from business done with the Federal Government. Moreover, they will not be taxed in any way with respect to reserves set aside for any necessary purpose, or reserves required by State law, if such reserves are allocated to patrons.

As a result of this action, all earnings or net margins of cooperatives will be taxable either to the cooperative, its patrons or its stockholders with the exception of amounts which are paid or allocated to patrons on the basis of purchases of personal, rather than business, expense items. With this exception, funds which are allocated to the accounts of patrons, or paid in cash or merchandise, are taxable to them. This is true in the case of either taxable or tax-exempt cooperatives. In the case of either a tax-exempt or a taxable cooperative funds which are paid or allocated to patrons on the basis of personal expense items have no income-tax consequences to the patrons, since they represent a return with respect to expenditures by the patron of a personal nature, for which no income tax deduction has been taken by him. Funds which are not paid or allocated to patrons but are retained as reserves by the cooperatives will be taxable to the cooperative. This also will be true of both types of cooperatives. Funds paid out as dividends on ordinary capital stock in the case of the exempt cooperative will be taxable to the stockholder, while in the case of the taxable cooperative a tax is imposed at both the stockholder and the cooperative levels.

While the tax treatment provided by your committee for cooperatives does not impose the double taxes payable in the case of ordinary corporate income, your committee believes that the securing of a single tax with respect to substantially all of the income of cooperatives should be sufficient in view of the unique characteristics of a cooperative.

Your committee disapproves of withholding on dividends. However, should withholding on corporate dividends be provided your committee believes it should also be provided for patronage dividends paid by cooperatives. For that reason your committee has added a provision to the bill which subjects patronage dividends of cooperatives to a withholding tax if at any time one should be imposed upon corporate dividends.

It has been contended that, although patronage dividends are generally taxable to the patron, the patronage dividends paid in scrip or some other noncash form have not been included in the patron's income. It has been suggested that this is true because

the patron who reports his other income on a cash basis is not accustomed to considering noncash payments as income. Also, it has been suggested that the patron is reluctant to include noncash patronage dividends in his income in many cases because he does not have sufficient other cash income available to pay the tax involved. To ascertain the degree to which both cash and noncash patronage dividends are included in returns at the present time your committee's bill provides that the Commissioner of Internal Revenue is to require reporting by all cooperatives of patronage dividends which are paid to or allocated to the accounts of patrons in amounts of \$100 or more, and is to have the discretion to require reporting on smaller amounts. Also, the committee has instructed the staffs of the Treasury Department and Joint Committee on Internal Revenue Taxation to study and report by April 1, 1952, the possibility of withholding against reserves allocated, and on the various methods used in allocating reserves and the form and character of the certificates issued.

It is estimated that the action provided by your committee with respect to exempt cooperatives will increase collections from this source in a full year of operation by \$10 million.

B. MUTUAL FINANCIAL INSTITUTIONS

1. *Mutual savings banks*

Mutual savings banks were established to encourage thrift and to provide safe and convenient facilities to care for savings. They also have the responsibility of investing the funds left with them so as to be able to give their depositors a return on their savings. Mutual savings banks were originally organized for the principal purpose of serving factory workers and other wage earners of moderate means who, at the time these banks were started, had no other place where they could deposit their savings.

Most mutual savings banks were started by groups of individuals who put up guaranty funds which were repaid out of subsequent earnings. The organizers appointed boards of trustees to manage the affairs of the banks. The boards of trustees, which are generally self-perpetuating, direct the policies of the banks, subject to the limitations imposed upon them by the laws of the several States in which they operate. The depositors themselves have no voice either in the choice of trustees or in the management of the bank's affairs. However, since a mutual savings bank has no capital stock, everything that the bank earns is, in theory, held for the benefit of the depositors.

With respect to outlets for their funds, mutual savings banks are subject to limitations similar to those which apply to other banking institutions. They are not required to make loans only to depositors or members. Table 9 shows the types of assets held by mutual savings banks as of December 30, 1950, and in the case of federally insured mutual savings banks, the types of real estate loans as of June 30, 1950, and their earnings, expenses, and dividends for the year ending December 30, 1950. The table indicates that United States Government obligations represent nearly 51 percent, and loans 38 percent of the total loans and investments of these banks. In the case of commercial banks nearly 49 percent of their total loans and investments represent United States Government obligations, and

41 percent represent loans.¹¹ This indicates that if there is any important difference between the use of funds by mutual savings banks and commercial banks, it is that the investments of the former are somewhat safer. Mutual savings banks, of course, have a larger portion of their loans in real estate than do commercial banks, but this can be attributed to the fact that since the deposits of mutual savings banks are almost exclusively time deposits, it is possible for them to invest a substantial portion of their funds in nonliquid assets. On the other hand, the majority of the deposits of commercial banks are demand deposits requiring greater liquidity in their investments. In any case, the investment of funds in real estate today is not a sign of insecurity in view of the fact that an important segment of such loans are backed by the Federal Government. Table 9 indicates in the case of federally insured mutual savings banks, for which statistics are available, that, as of June 30, 1950, about 33 percent of the real-estate loans held by these banks were either insured by the Federal Housing Administration, or guaranteed by the Veterans' Administration. Moreover, even the other real-estate loans are more secure than formerly was the case because of the present general use of "declining-balance" loans in lieu of the older "fixed-amount" loans.

The total deposits of mutual savings banks as of June 27, 1951, were \$20,400 million and their capital accounts, \$2,290,¹² indicating that they have about \$1 of capital for every \$9 of deposits. As of the same date the total deposits of all commercial banks were \$150,280 million, and their capital accounts \$11,860 million, indicating that they only have about \$1 of capital for every \$13 of deposits. Thus, despite the absence of capital stock the mutual savings banks today on this ground also appear to have considerably more protection than commercial banks.

¹¹ As of December 30, 1950. Computed from data available in the Federal Reserve Bulletin.
¹² These statistics are published regularly in the Federal Reserve Bulletin.

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TABLE 9.—Types of assets held by mutual savings banks as of Dec. 30, 1950, and for federally insured mutual savings banks, types of real estate loans held as of June 30, 1950, and earnings, expenses, and dividends in the calendar year 1950

I. ASSETS OF ALL MUTUAL SAVINGS BANKS IN THE UNITED STATES, AS OF DEC. 30, 1950

Item	Dollar amounts in millions
Total assets.....	\$22,385
Cash and funds due from banks.....	797
United States Government obligations.....	10,868
Obligations of States and subdivisions.....	88
Other securities.....	2,253
Real estate and other loans.....	8,137
Miscellaneous assets.....	242
Number of banks, 529.	

II. FEDERALLY INSURED AND CONVENTIONAL REAL ESTATE LOANS HELD BY INSURED MUTUAL SAVINGS BANKS, JUNE 30, 1950

Total real estate loans.....	\$5,447
Federally insured:	
Insured FHA and guaranteed VA mortgage loans on 1- to 4-family properties.....	\$1,364
Insured FHIA and guaranteed VA loans on 5 or more family properties.....	415
Total.....	1,779
Conventional loans.....	3,668
Number of insured mutual savings banks, 192.	

III. EARNINGS, EXPENSES AND DIVIDENDS OF INSURED MUTUAL SAVINGS BANKS FOR THE YEAR ENDING DECEMBER 30, 1950

Item	Dollar amounts in thousands
Current operating earnings, total.....	\$478,695
Interest, discount and other income on real estate loans.....	231,730
Interest on U. S. Government obligations, direct and guaranteed.....	182,457
Other current earnings.....	64,508
Current operating expenses.....	115,470
Net current operating earnings.....	363,225
Dividends (interest) paid on deposits.....	257,770
Net profits after interest and dividends.....	91,175
Number of insured mutual savings banks, Dec. 30, 1950, 194.	

Source: Annual Report of the Federal Deposit Insurance Corporation for the year ended Dec. 31, 1950, pp. 55 and 272, and Operating Insured Commercial and Mutual Savings Banks, Assets and Liabilities, June 30, 1950, Rept. No. 33, Federal Deposit Insurance Corporation.

Section 102 (2) of the code exempts mutual savings banks from the payment of any income tax. The effect of the exemption has been to relieve mutual savings banks of income tax on the amounts retained as undivided profits and additions to surplus. Since they have increased their surplus and undivided profits by over \$800 million since 1940, and by more than \$500 million since 1945, it would appear that they have enjoyed substantial tax savings as a result of the exemption.

Section 313 of your committee's bill removes the exemption of mutual savings banks and permits them to deduct amounts paid, credited or allocated to the accounts of depositors and, as in the case of other banks, permits them to deduct amounts credited to a reasonable reserve for bad debts. The addition to the reserve for losses on loans is to be determined with due regard to the taxpayer's surplus or loss reserves at the close of December 31, 1951. In addition, mutual savings banks are to be allowed as a deduction from

gross income any amount currently paid to the United States, or to any Federal Government instrumentality exempt from Federal income taxes, in repayment of indebtedness incurred prior to September 1, 1951. On the remaining income, mutual savings banks are to be taxed in the same manner as ordinary corporations. This provision is effective with respect to taxable years beginning after December 31, 1951.

The size of the bad-debt allowance provided in the case of commercial banks is determined under administrative rulings by the Commissioner of Internal Revenue. At present it is provided in the case of commercial banks that the amount which can be deducted from taxable income in any one year shall be determined by applying the ratio of losses to outstanding loans during the past 20 years, to the loans outstanding in the current year. These reserves are limited to three times the current 20-year loss ratio. In the case of mutual savings banks also, the formula permitted may be quite different from that now provided for commercial banks if the Commissioner after investigation finds that the historical loss experience of these institutions differs substantially from that of commercial banks. In fact, your committee believes that the loss experience of these banks should be based upon a period of at least 25 years if this, in the aggregate, would result in greater loss deductions for these banks than the 20-year period now provided in the case of commercial banks. Basing loss reserve deductions on the loss experience of the past 20 or 25 years will include a period in which the losses of the mutual savings banks were quite large, with the result that the loss reserve deductions permitted in the next several years will be relatively large.

At the present time, mutual savings banks are in active competition with commercial banks and life insurance companies for the public savings, and they compete with many types of taxable institutions in the security and real estate markets. As a result your committee believes that the continuance of the tax-free treatment now accorded mutual savings banks would be discriminatory. So long as they are exempt from income tax, mutual savings banks enjoy the advantage of being able to finance their growth out of earnings without incurring the tax liabilities paid by ordinary corporations when they undertake to expand through the use of their own reserves. The tax treatment provided by your committee would place mutual savings banks on a parity with their competitors.

Moreover, earnings of a mutual savings bank which are allocated to the accounts of depositors are subject to individual income tax. Since it is contended that the income which is retained by the mutual savings banks is the income of depositors, there seems to be no reason why this also should not be subject to tax. However, it is impossible to tax the depositors on these unallocated funds, since they have no legal right to the funds unless they are depositors at the time of liquidation of the bank. Therefore, if these earnings are to be recognized as income, there is no alternative but to tax them in the hands of the mutual savings banks which have the power over their management and disposition.

It has been suggested that mutual savings banks might be taxed only on their net income in excess of some specified reserve. However, if the funds going into this reserve represent income there would

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appear to be no reason for not taxing them. If they are funds which are necessary to offset future losses, allowance will already have been made for them through a loss-reserve deduction which will afford these institutions at least as generous treatment as is accorded their chief competitors, namely, commercial banks.

2. Savings and loan associations

Savings and loan associations were established to encourage thrift and to promote home ownership. These organizations, which also go under the name of building and loan associations, are typically nonstock corporations which in reality secure their funds through deposits, which are known as "shares." Savings and loan associations may be chartered by the States or by the Home Loan Bank Board. Of the 5,980 associations which were doing business at the end of 1949, 1,505 were Federal associations and the remainder were State-chartered institutions. The former group accounted for \$7.1 billion, or nearly 50 percent, of the \$14.7 billion of total assets of all the associations.

TABLE 10.—Types of assets held by savings and loan associations as of Dec. 30, 1950, and for federally insured associations, types of real-estate loans held as of Dec. 30, 1950, and income dividends and undivided reserves and profits in 1950

I. ASSETS OF ALL SAVINGS AND LOAN ASSOCIATIONS AND INSURED SAVINGS AND LOAN ASSOCIATIONS AS OF DEC. 30, 1950

[Dollar amounts in millions]

Item	All savings and loan associations	Insured savings and loan associations
Total assets.....	¹ \$16,925	\$13,644
First-mortgage loans.....	\$13,810	\$11,153
Cash.....	\$913	\$800
U. S. Government obligations.....	\$1,491	\$1,202
Number of associations.....	5,980	2,860

II. FEDERALLY INSURED AND CONVENTIONAL FIRST-MORTGAGE LOANS HELD BY INSURED SAVINGS AND LOAN ASSOCIATIONS, DEC. 30, 1950

[Dollar amounts in millions]

Total first-mortgage loans.....	² \$11,188
Federally insured:	
VA-guaranteed loans.....	\$733
FHA-insured loans.....	2,507
Total.....	3,241
Conventional loans.....	7,947

III. INCOME, DIVIDENDS, AND UNDIVIDED PROFITS OF INSURED SAVINGS AND LOAN ASSOCIATIONS, FOR THE YEAR ENDED DEC. 30, 1950

[Dollar amounts in thousands]

Net income.....	\$411,347
Dividends.....	262,781
Undivided profits and reserves.....	148,566

¹ Preliminary.

² The difference between this figure and the comparable category shown in pt. I is due to differences in accounting methodology.

Sources: Statistical Summary, 1951, Home Loan Bank Board, pp. 8 and 14; Operational Analysis Section, Home Loan Bank Board.

Not all of the earnings of savings and loan associations are distributed in the form of cash or credited to the shareholders' accounts. Some earnings are set aside in various reserve accounts, and some are